

## Message Text

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PAGE 01 BUENOS 07626 131138Z

ACTION ARA-14

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-07

L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15

USIA-06 AID-05 COME-00 EB-08 FRB-03 TRSE-00

XMB-02 OPIC-03 LAB-04 SIL-01 OMB-01 CEA-01 STR-05

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FM AMEMBASSY BUENOS AIRES

TO SECSTATE WASHDC 2688

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E.O. 11652: N/A

TAGS: EFIN, AR

SUBJECT: INTEREST RATES IN ARGENTINA SOAR

1. SUMMARY: SINCE AUGUST, INTEREST RATES HAVE SOARED AS A RESULT OF A DELIBERATE GOA POLICY. BANKERS ARE CONCERNED AT THE DECREASED SPREAD BETWEEN BORROWING AND LENDING RATES AND THE RISK OF EXTENDING LOANS WITH A TERM OF OVER 30 DAYS. INVESTORS ARE COMPLAINING THAT INTEREST RATES ARE STILL NEGATIVE. BUSINESSMEN BELIEVE THE COST OF BORROWING IS TOO HIGH AND ARE PREDICTING DOOM. THE GOA PLANS TO MAINTAIN ITS TIGHT MONEY POLICY UNTIL YEAR-END AT LEAST AND SEEMS UNCONCERNED ABOUT POSSIBLE DAMPENING EFFECT ON THE ECONOMY.

2. SINCE AUGUST, LOCAL INTEREST RATES HAVE SOARED, REFLECTING A COMBINATION OF FACTORS, TIGHT MONEY POLICY; INCREASED FINANCING OF THE TREASURY DEFICIT THROUGH PUBLIC BORROWING; LARGE BORROWINGS FROM PRIVATE COMMERCIAL BANKS BY STATE ENTERPRISES; AND HIGH INFLATIONARY EXPECTATIONS. THE EFFECTIVE RATE OF RETURN (COMPOUNDED ANNUAL RATES) OFFERED INVESTORS RANGES FROM AS LOW AS 149 PERCENT FOR AN 119 DAY TREASURY BILL TO 184 PERCENT FOR A 30-DAY SAVING DEPOSIT. THE COST OF 30-DAY MONEY FOR BORROWERS IS NOW

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PAGE 02 BUENOS 07626 131138Z

AROUND 250 PERCENT PER YEAR.

3. ALTHOUGH THE SPREAD BETWEEN THE BORROWING AND LENDING RATES SEEMS ENORMOUS, BANKING SOURCES INDICATE THAT THE MARGINS ARE MUCH SMALLER IN REALITY AND HAVE BEEN DECREASING AS A RESULT OF COMPETITION AMONG COMMERCIAL BANKS AND PARTICULARLY THAT OF THE STATE-OWNED BANCO DE NACION WHICH HAS ACTIVELY SOUGHT TO

REDUCE

BANKING PROFIT MARGINS (IF PRESSED, MOST BANKS WILL ADMIT TO EXTREMELY FAVORABLE BALANCE SHEETS IN 1977). SOURCES POINT OUT THAT SPREADS HAVE TO INCLUDE LOSSES REFLECTING THE DIFFERENCE BETWEEN THE CENTRAL BANK CHARGES ON INTEREST-FREE DEMAND DEPOSITS AND COMPENSATIONS FOR FUNDS HELD ON INTEREST-BEARING TIME DEPOSITS FOR RESERVE REQUIREMENTS (IN VIEW OF 45 PERCENT RESERVE REQUIREMENT, COMPENSATION ON TIME DEPOSITS IS DEEMED NECESSARY TO ALLOW BANKS TO OFFER HIGH INTEREST RATES TO INVESTORS AND ENCOURAGE PUBLIC SAVING), AS WELL AS A SERIES OF TAXES ON FINANCIAL TRANSACTIONS. MOREOVER, SOME FINANCIAL INSTITUTIONS HAVE SUFFERED SERIOUS LOSSES AS A RESULT OF OBTAINING MONEY ON 30-DAY TERMS AND RELENDING IT AT 90 OR 180 DAYS, BOTH AS A RESULT OF THE INCREASED COST OF OBTAINING NEW FUNDS AT THE END OF THE INITIAL PERIOD OF 30 DAYS, AS WELL AS THE INCREASED LOSSES FROM THE DIFFERENCE BETWEEN CENTRAL BANK CHARGES AND COMPENSATIONS. AS A RESULT OF THE INCREASED UNCERTAINTY ON REAL RATES ON LONGER TERM DEPOSITS AND LOANS OR BOTH INVESTORS AND LENDERS, VIRTUALLY ALL INVESTMENTS AND LOANS HAVE A MATURITY OF 30 DAYS OR LESS.

4. NEITHER INVESTORS NOR BUSINESSMEN BORROWERS ARE PLEASED WITH THE CURRENT SITUATION. INVESTORS ARE COMPLAINING THAT INTEREST RATES ARE STILL NEGATIVE BUT NONETHELESS HAVE BEEN UNWILLING TO COMMIT THEMSELVES IN A LARGE SCALE TO PUTTING THEIR FUNDS IN NATIONAL ADJUSTABLE BONDS -- PROBABLY BECAUSE COMMISSION CHARGES LIMITED OFFICIAL USE

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PAGE 03 BUENOS 07626 131138Z

ON SALES AND PURCHASES ON BONDS ARE SO LARGE THAT HOLDING THEM FOR ONLY A SHORT PERIOD WOULD RESULT IN A LOSS AND HOLDING THEM UNTIL MATURITY WOULD MEAN FOREGOING OTHER MORE ATTRACTIVE INVESTMENT OPPORTUNITIES WHICH MIGHT PRESENT THEMSELVES LATER ON. BUSINESSMEN RESENT HAVING TO PAY POSITIVE OR SLIGHTLY NEGATIVE INTEREST RATES AND PROJECT DOOM UNLESS THE CENTRAL BANK REVERSES ITS CURRENT POLICY. BANK SOURCES, ON THE OTHER HAND, ARE NOT OVERLY CONCERNED OVER THE POTENTIAL EFFECT ON THEIR CLIENTS. THEY STATE THAT MOST COMPANIES ARE KEEPING THEIR BORROWING AT A MINIMUM AND ARE FINANCIALLY CAPABLE OF BEARING THE INCREASED FINANCIAL COSTS. THEY ADMIT, HOWEVER, THAT SOME SMALL AND MEDIUM-SIZED COMPANIES WHICH WERE FORMERLY HIGHLY DEPENDENT ON SUBSIDIZED INTEREST RATES MAY BE IN SERIOUS STRAITS AND EVEN GO BANKRUPT. SOURCES EXPECT INTEREST RATES TO REMAIN HIGH UNTIL YEAR-END AND THEN BEGIN TO DECLINE.

5. COMMENT: AS MINISTER OF ECONOMY MARTINEZ DE HOZ PREDICTED IN HIS ECONOMIC REPORT TO THE JUNTA, CRITICISM AGAINST THE GOVERNMENT FOR ADOPTING AN OVERLY EXPANSIONARY MONETARY POLICY DURING THE FIRST HALF OF THE YEAR HAS NOW BEEN REPLACED BY HOWLS OF PROTEST AGAINST THE GOVERNMENT'S TIGHT MONEY POLICY. COMBATING INFLATION IS THE MAIN OBJECTIVE

AND THERE IS LITTLE CONCERN ABOUT THE POSSIBLE ADVERSE IMPACT  
OF HIGH INTEREST RATES ON GROWTH. GOA OFFICIALS ARE BULLISH  
ABOUT GROWTH OF PRODUCTION IN 1978 AND IF ANYTHING ARE  
CONCERNED THAT THE ARGENTINE ECONOMY MAY BECOME OVERHEATED.  
IF THE TIGHT MONEY POLICY SHOULD DRIVE SOME SMALL FIRMS INTO  
BANKRUPTCY, HOWEVER, POLITICAL PRESSURES FOR A REVERSAL OF  
CURRENT MONETARY POLICY ARE BOUND TO BUILD UP.  
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## Message Attributes

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